

**November 28, 2017**

## **Introduction and Purpose**

Staff of the Alberta Securities Commission (Staff or we) recently completed a survey of investors and an analysis of the use of section 2.5 *family, friends and business associates* (the FFBA Exemption) of National Instrument 45-106 *Prospectus Exemptions* (NI 45-106). We are publishing this notice to provide a summary of the analysis, as well as guidance to issuers that have relied on, or intend to rely on the FFBA Exemption. Dealers and investors (i.e. purchasers under the exemption) also may be interested in the results of the analysis and the guidance to understand who may qualify as a purchaser under the exemption.

## **Background**

### *Project Summary*

The primary objectives of the survey were to gain a better understanding of how the FFBA Exemption is being used by issuers, to assess overall compliance with the requirements of the exemption, and to determine whether there are any areas of improvement for issuers relying on the exemption.

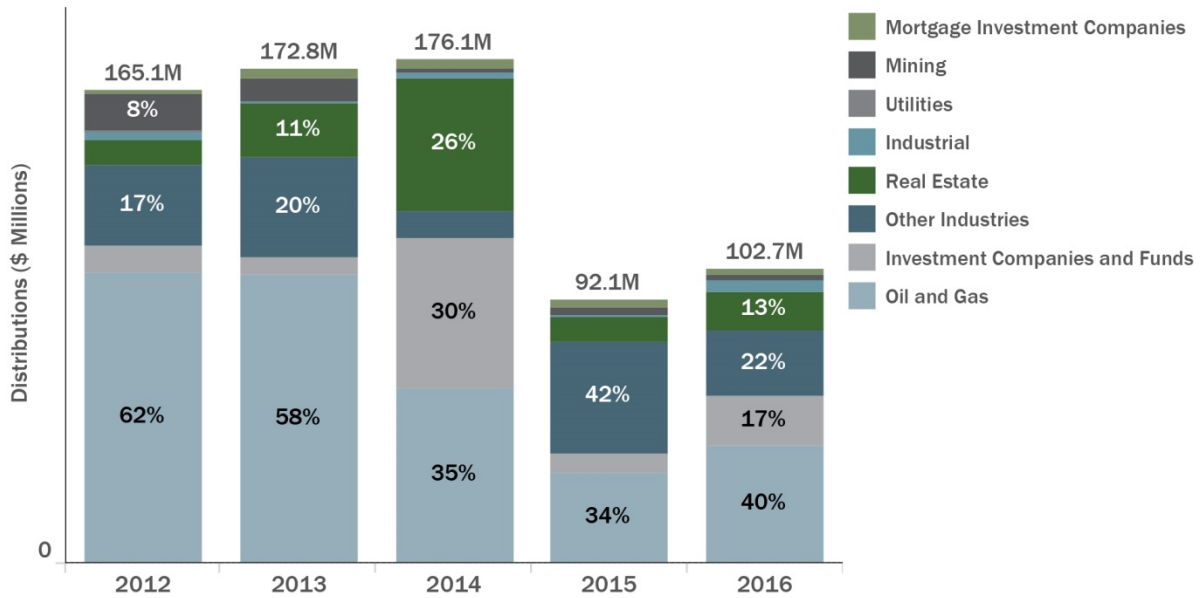
The FFBA Exemption is used regularly in Alberta. Chart 1 shows total distributions by Alberta issuers under the FFBA Exemption over the last five calendar years.<sup>1</sup> Based on reports of exempt distribution<sup>2</sup> filed with the Alberta Securities Commission (the ASC), the most commonly reported industry type among issuers relying on the FFBA Exemption was “oil and gas,” followed by “other industries,” “investment funds and companies” and “real estate.”

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<sup>1</sup> For additional detail on the use of prospectus exemptions in Alberta, refer to The Alberta Capital Market 2017 report available on the website of the ASC.

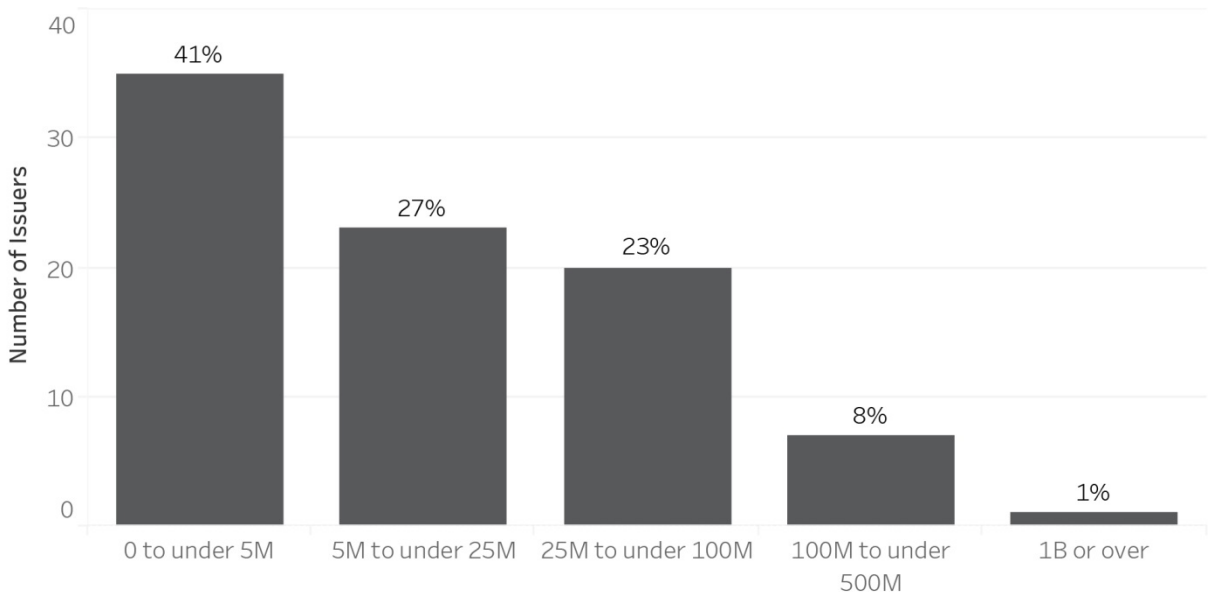
<sup>2</sup> Form 45-106F1 *Report of Exempt Distribution*

**CHART 1: DISTRIBUTIONS BY ALBERTA ISSUERS UNDER FFBA EXEMPTION FOR THE PAST FIVE YEARS, BY INDUSTRY**



We also reviewed reports of exempt distribution to analyze the typical asset size of issuers that used the FFBA Exemption. Chart 2 shows the number of issuers in each asset range for the last six months of 2016, as the size of assets field was introduced with amendments to the report of exempt distribution that took effect on June 30, 2016. Based on reports of exempt distribution filed with the ASC, two-thirds of issuers relying on the FFBA Exemption were small issuers with assets of less than \$25 million.

**CHART 2: NUMBER OF ALBERTA ISSUERS DISTRIBUTING UNDER FFBA EXEMPTION, BY ASSET SIZE**



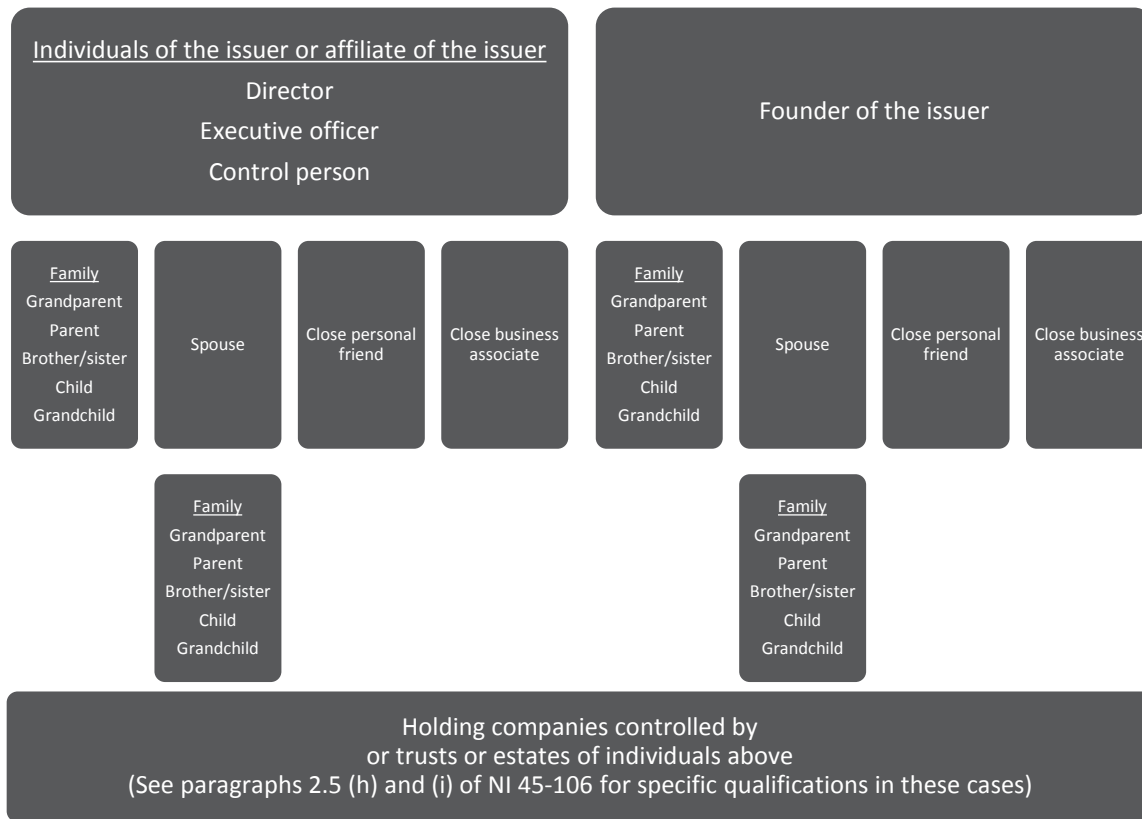
For the survey, we identified all distributions made using the FFBA Exemption in Alberta in 2016, as well as distributions made using the FFBA Exemption in 2015 by issuers who distributed using this exemption in 2016. From this population, we randomly selected a sample of 500 investors to whom distributions were made, ensuring that at least one distribution was selected for each issuer in the sample. In total, 266 unique issuers were included in the sample. We received 232 responses to the survey, for a response rate of 46%. There were 141 unique issuers represented in the responses, or 53% of issuers using the exemption during the period.

A total of three different surveys were developed and used for the project: one sent to individual investors, one sent to non-individual investors (i.e. companies and estates), and one sent to those individuals identified through the non-individual investor surveys.

### *Who Qualifies under the FFBA Exemption*

The illustration in Chart 3 depicts who an issuer is able to distribute securities to under the FFBA Exemption. Generally, the FFBA Exemption requires a close personal relationship of the investor with certain individuals of the issuer. The relationship must also be direct. Sections 2.7 and 2.8 of Companion Policy 45-106CP *Prospectus Exemptions* (45-106CP) give guidance on relevant factors of closeness.

**CHART 3: PURCHASERS WHO MAY QUALIFY UNDER THE FFBA EXEMPTION\***



\*NOTE: The above graphic is for illustrative purposes. Issuers intending to rely on the FFBA Exemption should review section 2.5 of NI 45-106 to ensure the exemption is available.

## **Key Findings**

### *Directors, Executive Officers, Founders, and Control Persons of the Issuer*

Of the responses received, 34 individuals identified themselves as either a director, executive officer, founder or control person of the issuer. Because these purchasers qualify automatically under paragraph 2.5(a) of the FFBA Exemption, no further responses to the survey questions were required. The remaining analysis in this notice is based on responses provided by purchasers other than those that qualify under paragraph 2.5(a) of the FFBA Exemption.

### *Close Relationship*

To qualify for the FFBA Exemption, a relationship with a friend or business associate must be a close relationship. The survey asked whether each respondent considered their relationship with the individual they knew at the issuer to be close. From the responses received, 75% responded that they considered the relationship to be close, while 25% responded that either the relationship was not close or they were unsure as to whether it was a close relationship.

The survey also asked respondents to elaborate as to why they considered their relationship close. Based on the responses, it was clear that several relationships did not meet the requirement for closeness under the FFBA Exemption, despite the fact that the respondent considered their relationship to be close.

Some examples of reasons provided by respondents that do not meet the closeness requirement include discussing business matters, being a shareholder in each other's companies, or having similar values, a similar background or being part of the same age group.

### *Who the Contact Person is*

The FFBA Exemption requires that an investor has a relationship with a director, executive officer, control person or founder of the issuer. The survey asked respondents whether the person with whom they had a relationship that led to the investment worked for the issuer, who we refer to in this notice as the purchaser's contact. Of the responses, 84% indicated that their contact did work for the issuer, while 11% indicated that they did not and 5% stated they were unsure.

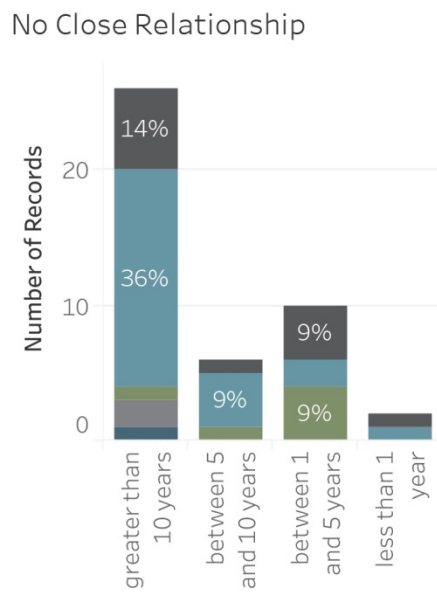
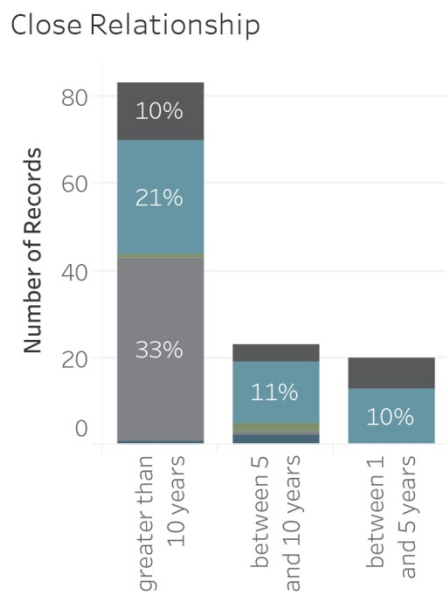
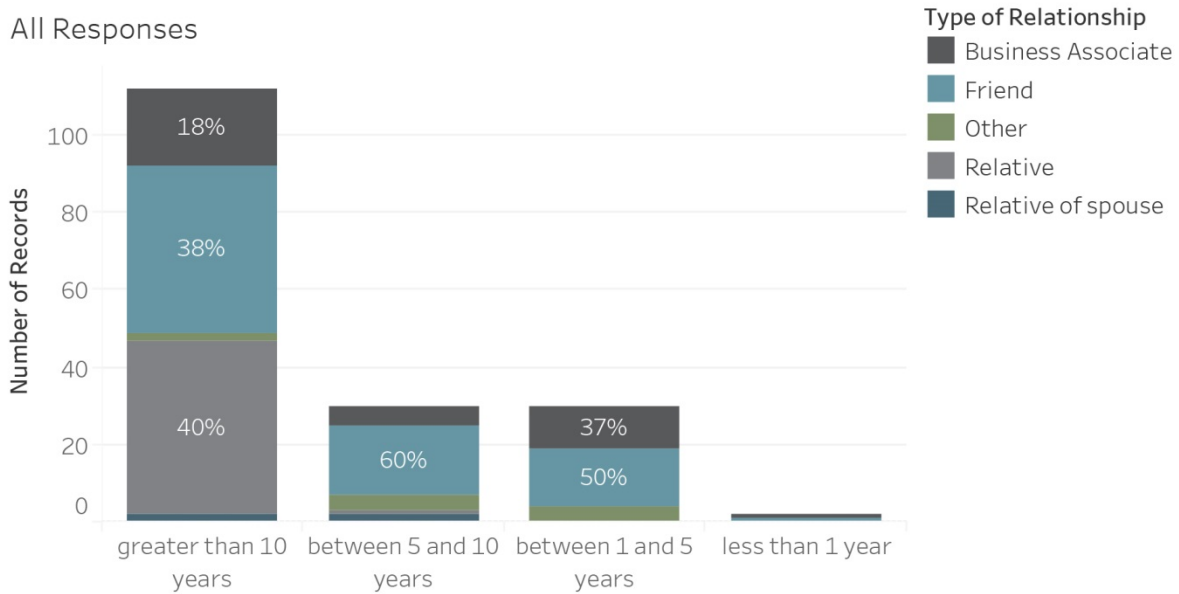
The survey also asked respondents to indicate their contact's position with the company. Of those who responded that their contact worked for the company, nearly all of the responses met the requirements of the FFBA Exemption in that the contact was a director, executive officer or control person of the issuer.

Some respondents noted that the contact person was an employee or contractor of the issuer, or the contact person was an employee of the dealer who facilitated the purchase. Relationships between the purchaser and individuals in these roles do not meet the requirements of the exemption.

### Duration of Relationship

The survey asked respondents how long they had known their contact at the issuer. Based on the results, 66% of those who believed their relationship was close indicated that they had known the individual for greater than 10 years. Of these, 41% were relatives or relatives of their spouse, shown in Chart 4. Where respondents did not believe their relationship with the issuer contact was close, the average duration of the relationship was lower, and the majority were friends or business associates.

**CHART 4: DURATION OF RELATIONSHIP**

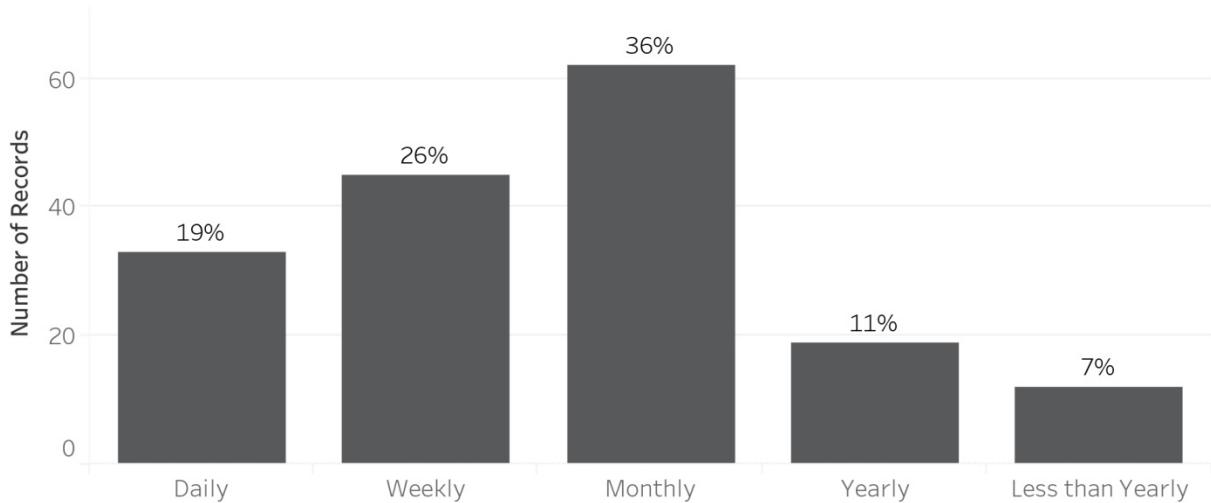


### Frequency of Contact

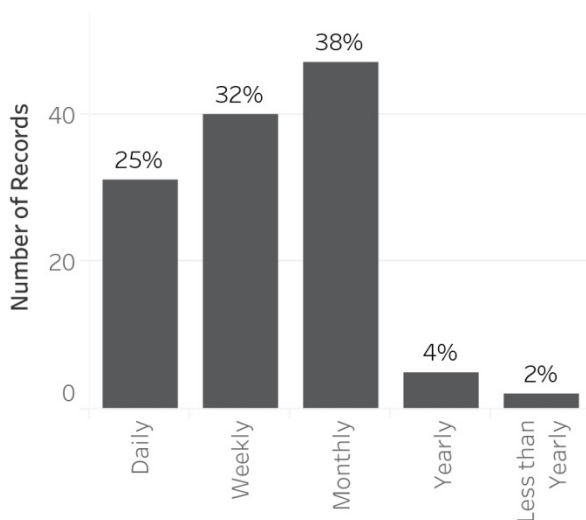
The survey asked respondents how often they were in contact with the individual with whom they had a relationship prior to first learning about the investment. The most prevalent response was monthly, followed by weekly and daily, as shown in Chart 5. For those who considered their relationship to be close, 94% were in contact at least monthly. For those who did not consider their relationship to be close, 56% were in contact on an annual basis or less frequently.

**CHART 5: FREQUENCY OF CONTACT**

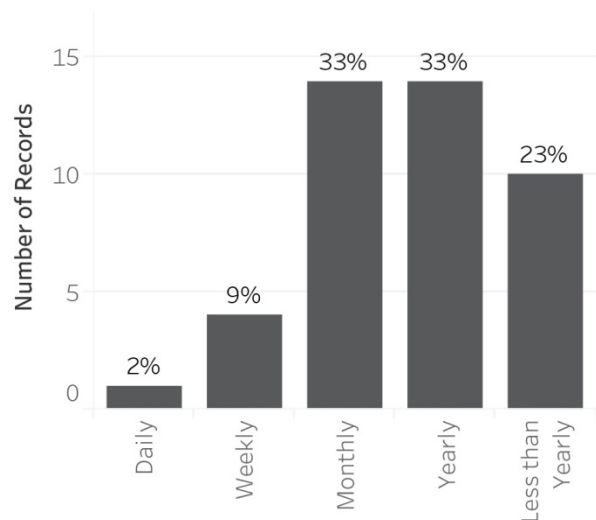
#### All Responses



#### Close Relationship



#### No Close Relationship

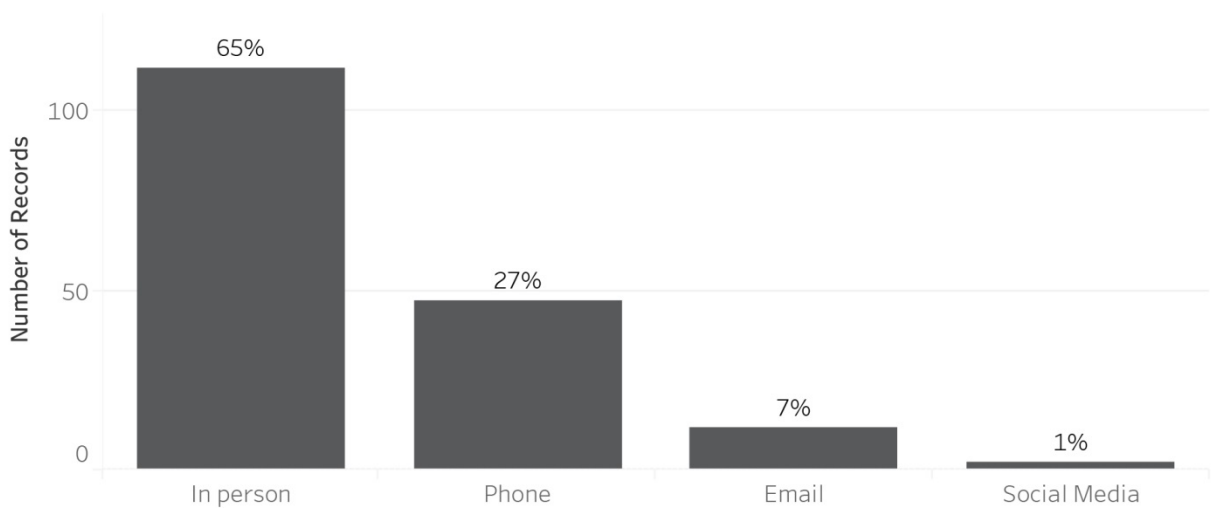


### Form of Contact

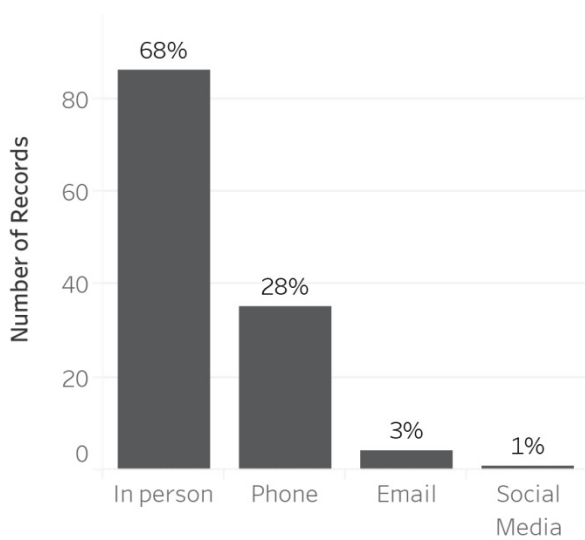
The survey asked what the most typical form of contact between the respondents and their contact with the issuer was. Regardless of whether investors felt that their relationship with their contact was close, the majority of investors interacted with their contact in person. However, for investors who said their relationship with their contact was close, email was used as the primary form of contact by only 3% of the respondents, compared with 18% of those with no close relationship as shown in Chart 6. Very few respondents interacted primarily through social media.

**CHART 6: FORM OF CONTACT**

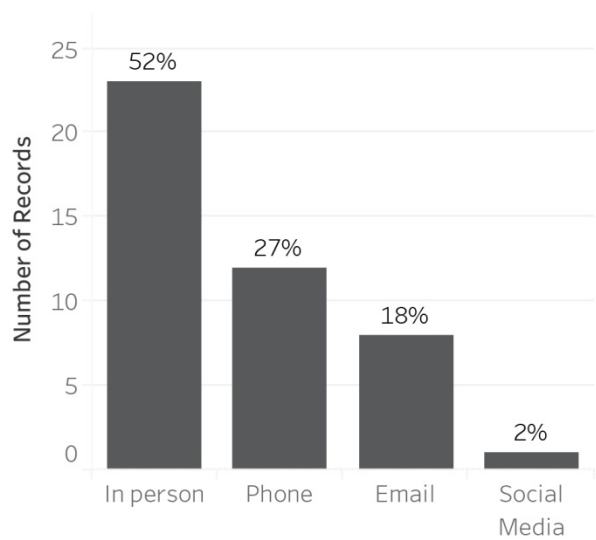
#### All Responses



#### Close Relationship



#### No Close Relationship



## **Guidance**

The results of the survey showed that the majority of respondents believed they had a close relationship with their contact person at the issuer, and that their contact person worked for the issuer in a capacity required by the FFBA Exemption. However, we did note areas where compliance could be improved.

### *Who the Relationship is Between*

Issuers are reminded that in order to rely on the FFBA Exemption, a purchaser must be a family member, close personal friend or close business associate of either a director, executive officer, control person or founder of the issuer. Relationships with other employees of the issuer do not meet the requirements of the FFBA Exemption.

In the context of the FFBA Exemption, “family” refers only to a spouse, parent, grandparent, brother, sister, child or grandchild of the contact person of the issuer. Any other extended family members are considered relatives, and therefore must pass the test of a close friend or business associate.

The FFBA Exemption also requires that the relationship be direct. The spouse of a close friend or business associate does not qualify to purchase securities under the exemption.

### *What is Considered Close*

Issuers should review sections 2.7 and 2.8 of 45-106CP for guidance as to whether a relationship with a friend or business associate would be considered close in the context of the FFBA Exemption.

As discussed in the 45-106CP, of significant importance in determining whether a relationship would be considered close is whether a purchaser is able to assess their contact’s capabilities and trustworthiness. Some of the factors in the 45-106CP are highlighted in the survey results in this notice, such as the length of time the individual has known the contact person and the frequency of contact between them. The results of the survey also show that close relationships tend to have a greater frequency of personal interaction than relationships that are considered to be not close.

Issuers should ensure that the purchaser considers the relationship to be close, as any relationship not considered close by the purchaser would be deemed not to be close by the ASC.

### *Issuers’ Responsibilities Where a Dealer is Involved*

Issuers are reminded that it is the responsibility of the issuer to ensure that the purchaser meets the characteristics required under the prospectus exemption being relied on, regardless of whether or not a dealer is involved in the distribution. Where a dealer is involved in a distribution under a prospectus exemption, the dealer or representative has a similar obligation to ensure the exemption is available, including that the purchaser meets the characteristics required



under the exemption. This obligation is in addition to a registered dealer's obligations respecting suitability. We expect issuers to have policies and procedures in place to confirm that all parties involved in the distribution understand the exemption being relied on, are able to describe the terms of the exemption to purchasers and know what information and documentation must be obtained from purchasers to confirm the conditions of the exemption have been satisfied. Section 1.9 of 45-106CP contains guidance on processes and record keeping when verifying purchaser status.

### **Questions**

Please refer your questions about this notice to any of the following:

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